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FINANCIAL IRRESPONSIBILITY:

Background Information for Security Personnel

Richards J. Heuer, Jr.

September 1991

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Preface

This study of financial issues is the second in a series of studies of behaviors that raise questions about personnel security and suitability. A previous study dealt with alcohol use and abuse. Future studies will deal with compulsive gambling, nonconforming sexual behavior, criminal behavior, and drug abuse. These reports are part of the research agenda recommended by the 1985 Stilwell Commission Report, *Keeping the Nation's Secrets*, a Report to the Secretary of Defense by the Commission to Review DoD Security Policies and Practices.

Investigators, polygraphers, adjudicators and managers involved in the security clearance process need a good perspective on what behavior is going on in society as a whole, what is common, what is uncommon, and what indicators may be available that a problem is either more serious or less serious than appears on the surface. This series of studies is intended to provide such background information.

This unclassified report does not make policy recommendations. It is up to individual managers and supervisors to judge the significance of this information for their activities and to communicate appropriate guidance to their personnel. The report will be most useful if it is integrated into a training program, or if it precipitates a review of adjudication and investigative policies and procedures relating to financial issues. The report may also be helpful to counsellors in employee assistance programs.

This report was prepared by the Central Intelligence Agency using the support facilities and assistance of the Defense Personnel Security Research and Education Center, and it is being disseminated by both organizations.

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Executive Summary

Financial irresponsibility is one of the criteria that justifies denial or revocation of security clearance. This study discusses the relationship between financial problems and personnel security, provides information on the prevalence of various types of financial problems in the U.S. population as a whole, describes ways to identify and judge the severity of financial problems, and points out the relationship between financial problems and other types of behavior of security interest.

A study of 115 Americans arrested for espionage between 1945 and 1990 showed that at least 67.8% were motivated by money, and money was the primary motive in at least 52.2% of the cases.

The figures in this study on numbers of people who default on financial obligations paint a general picture of the frequency of financial problems encountered by Americans. This enables one to evaluate the financial behavior of individuals against a backdrop of what is happening in society as a whole.

The frequency of bankruptcy has increased dramatically since a new bankruptcy law went into effect in 1979. There were 782,960 bankruptcy filings during 1990, which is one bankruptcy filing for every 120 households. This varied greatly from state to state. In Tennessee, one out of every 51 households sought bankruptcy protection. Nationwide, the bankruptcy rate jumped by 28% during the first quarter of 1991 as compared with the previous year.

Delinquency rates are reported for many types of loans. For bank credit cards, 2.56% of the revolving accounts representing 4.46% of all bankcard debt were overdue by 90 days or more in late 1990. Visa and MasterCard wrote off $5.9 billion in bad debt during 1990, which was 3.37% of outstanding credit balances.

For loans by car dealers, the delinquency rate in March 1990 was 2.3%, while the rate of repossession was 2% per year. In the third quarter of 1990, 5% of all home mortgages were at least 30 days overdue. These figures vary substantially from state to state and for different kinds of mortgages and car loans.

The IRS estimates that about 6 to 7 million Americans who owe tax fail to file federal income tax returns each year. This is a failure-to-file rate of about 5.5% This is

an important indicator, as failure to file income tax returns has been found to be a common practice among persons arrested for espionage. Of 44 persons arrested for espionage since 1980, 17 (or 38.6%) failed to file an income tax return during at least one year prior to their arrest. At least 13 and possibly all 17 of them did have a tax obligation during the tax year in question.

About 17% of borrowers in the federal guaranteed student loan program were in default during 1990, and these defaults cost the federal government $2.4 billion during that year. The default rate for students who had attended four-year colleges was 10%, for those from two-year schools it was 20% to 25%, while students from trade schools defaulted at a 39% rate.

Of fathers with a legal obligation to pay child support, only 48% were paying the full amount. Twenty-six percent, or 1,395,680 fathers, paid nothing at all, while another 26% paid less than the full amount. As a result of collection programs sponsored by the federal government, both student loan obligations and child support obligations are being recorded with increasing frequency on credit reports.

The Consumer Credit Counseling Service (CCCS) provided free or low cost counseling services to approximately 390,000 persons during 1990. Almost half of those receiving services from CCCS report that their financial problems were caused by reasons somewhat beyond their control--unemployment, accident or disability, divorce or separation, or unexpected medical expenses. The average CCCS client had gross monthly income of $1,840 and total consumer debt (not counting mortgage or rent) of $16,548 owed to 11 creditors. About 30% of CCCS clients were able to help themselves after receiving budget counseling services, while 37% required a debt repayment program.

The rule of thumb used by credit counselors is that if a person's monthly payments for consumer credit (excluding mortgage but including car payments) are more than 20% of monthly take-home pay, that individual is in serious financial difficulty. A 1981 study of persons filing for bankruptcy found that 91% failed this 20% test. Within the general population, only 5% are this burdened with consumer debt.

Various patterns of compulsive behavior center around the theme of money--either spending it, saving it, or taking risks with it. Compulsive gambling and compulsive shopping are of security concern as potential sources of financial problems. Such a large percentage of compulsive gamblers engage in illegal activities to finance their gambling that compulsive gambling will be the subject of a separate report.

Compulsive gambling and compulsive spending are often found together with other compulsive behaviors. A study of female compulsive gamblers found that 54% had been dependent upon something else (alcohol, drugs, overeating, overspending, sexual addiction) at some point in their lives.

Financial problems sometimes lead to crime in a desperate effort to meet financial needs. The white-collar crimes of embezzlement, forgery/counterfeiting, and fraud are often crimes of opportunity committed by persons in a position of trust who find themselves in a financial bind or who fall to the temptations of an extravagant lifestyle. Espionage is a similar crime where a person misappropriates information rather than money.

During 1989, there were 6.5 arrests for embezzlement per 100,000 inhabitants of the U.S., 40.5 arrests per 100,000 inhabitants for forgery and counterfeiting, and 145 per 100,000 for fraud. For some reason, arrests for these crimes are about twice as common in the South as in other parts of the country. Reports of arrest for embezzlement increased by 80.6% from 1980 to 1989 as compared with an increase of 27.7% for other crimes. The number of women committing financial crimes increased sharply during this same period, presumably reflecting the changing role of women in the work force. During 1989, more than one-third of the financial crimes of embezzlement, forgery/counterfeiting and fraud were committed by women.

These disturbing figures confirm the need for careful investigation of financial issues. Common sense and experience suggest that financial difficulties may increase temptation to commit illegal or unethical actions. One must remember, however, that many such acts are committed out of simple greed, not need, and that the great majority of those with financial difficulties are not inclined to commit illegal acts at all.

Table of Contents

List of Tables

List of Figures

Introduction

Financial irresponsibility is one of the criteria that may justify denial or revocation of security clearance as specified in Director of Central Intelligence Directive No. 1/14 and Department of Defense Regulation DoD 5200.2-R. A recent study analyzed the issues that arose in a sample of 7,232 Special Background Investigation cases adjudicated by 14 different federal agencies. In those cases when a single issue was identified by the investigation, it was a financial issue 16.6% of the time. Of all the single issue cases, finances were the basis for 30% of the denials. In cases where three or more issues were identified, finances were one of the issues 48.2% of the time and were one of the reasons for almost 59% of the denials.[1]

The present study provides background information on financial issues. Most of the data fall into four general categories.

- Statistics on the prevalence of bankruptcy and delinquency on various types of debt among the U.S. population are cited.

- Potential indicators of financial problems are identified and assessed. For example, the rule of thumb used by credit counselors is that an individual's monthly payments for consumer credit should not exceed 20% of take-home pay.

- The relationship between financial problems and other problem behaviors is discussed, particularly the relationship with white collar crime and various compulsive behaviors.

- Potential mitigating factors are noted.

This report is based on a review of relevant literature and contact with organizations that track consumer financial behavior. It pulls together a wide variety of information that may be useful to personnel security policy makers, practitioners, and researchers when reviewing standards and procedures or establishing priorities. It will also be helpful for counsellors in employee assistance programs.

Some caution is in order when using statistical data about the prevalence of any type of behavior, as such information may be misleading and can be misused. Statistics that apply to the overall population will generally be different from the frequency rates found in a select and pre-screened pool of persons undergoing security processing. Further, statistical frequency should not be used as the basis for judging the acceptability of behavior. Rather, behavior should be judged on the basis of its relevance to security and work performance, not on the grounds that "lots of people are doing it." Nor should the statistics be used to create stereotypes that bias the investigation against higher risk categories of applicants.

Financial Problems and Personnel Security

Excessive indebtedness, recurring financial difficulties, or unexplained affluence are grounds for denying security clearance. Specific adjudication standards are cited in an Appendix to this report. Increased sensitivity to the potential importance of financial issues has in recent years caused a sharp increase in the number of security clearances being denied on financial grounds.

Money has been a major incentive in most recent cases of espionage and in many other cases of illegal behavior by government employees. The John Walker and Jerry Whitworth espionage cases which resulted in extensive compromise of U. S. military communications secrets are prime examples. Financial difficulties were the initial impetus for Walker to volunteer his services to the Soviets and for Whitworth's agreeing to help him, and financial gain was a continuing motivation for their cooperation.[2]

According to a study now underway of 115 Americans arrested for espionage between 1945 and 1990, at least 67.[illegible]% were motivated by money. In at least 52.2% of the cases, money was the primary motivation. Of those with financial motivation, at least 30% are known to have had significant debts, while the others may have been motivated mainly by greed. This study is based only on unclassified information, so the data are incomplete.[3]

A different study of 44 Americans arrested for espionage since 1980 showed that a check of Internal Revenue Service master file records alone (not the individual Form 1040 records) would have raised significant financial issues concerning nearly half of them. Out of the 44 cases, 13 to 17 individuals who had a tax obligation failed to file a tax return during at least one year prior to their arrest. (The number is uncertain, as in four cases it has not been determined whether the individual actually had a tax obligation during the tax year in question.) Such failure to file is surprisingly common, as discussed below. In four cases in which returns had been filed, tax payments were delinquent and the individual had significant difficulties with the IRS prior to arrest for espionage.[4]

Whether motivated by need or greed, recent Defense procurement scandals have also heightened awareness of financial issues in the adjudication process. Most white-collar crime is committed by long-term, trusted employees who develop financial difficulties, or by persons seeking to live a lifestyle well beyond their financial means. According to one estimate, white-collar crime bleeds American business of $40 billion per year.[5] In retail stores, losses from theft by one's own employees have increased greatly in recent years and are now believed to be three times as great as losses to theft by outsiders.[6] Personnel security specialists report that 30% to 40% of employees from retail, restaurant, manufacturing and health care industries admit to costly employee theft, and that as many as 30% of all business failures are due to employee theft and related forms of dishonesty.[7] No estimate is available of the cost to the U.S. Government from fraud or theft by its own employees.

After 1988 when the polygraph was outlawed for most employers as an employee screening tool, many American businesses turned to using credit reports as an alternative means of judging whether a prospective employee is likely to steal, sell company secrets or otherwise act irresponsibly on the job. They contend that knowing how a person handles bills, loans and other financial obligations is a useful predictor of how the person might act on the job. The three largest credit report vendors started marketing what they call employee screening reports in 1988 or 1989, and sales have grown dramatically.[8]

Critics in some personnel assessment firms, however, point out that there is no statistical evidence of a link between financial problems and dishonesty. Credit records contain many inaccuracies, honest people can accrue bad credit records, and people with clean credit records are not immune to temptation.[9]

Common sense and experience suggest that financial difficulties may increase temptation to commit illegal or unethical acts as a way of meeting financial obligations. One must always remember, however, that many such acts are committed out of simple greed, not need, and that the great majority of those with financial difficulties are not inclined to commit illegal acts at all. Existence of personal financial difficulties should not always bar an otherwise qualified applicant for security clearance. Income from the new job may be all that is needed to solve the financial problem.

Financial problems ought to be viewed in the context of what has caused them and what is being done to resolve them. One survey of persons seeking financial counseling suggests that in about half the cases, the financial problems arose through little or no fault of the individual. They were caused by loss of job, divorce or separation, accident or disability, or unexpected medical bills.[10] If there is no clear personal fault, an individual's financial difficulties should not be compounded by denial of security clearance, especially if the individual has demonstrated intention and ability to gain control over his or her financial situation.

At the other extreme are those whose financial problems stem from personality flaws with broader security ramifications--compulsive gambling, compulsive shopping, drug or alcohol abuse. Compulsive behavior is a form of emotional disorder in which one loses control over one's own actions. It impairs judgment and can easily lead to illegal or unethical acts in a desperate attempt to recover from self-inflicted financial adversity. For example, one study found that 21% of a sample of Gamblers Anonymous members and 46% of a sample of pathological gamblers treated by the Veterans Administration had been arrested specifically for one or more of a small group of crimes all resulting from attempts to obtain money for gambling.[11]

A third grouping consists of those whose problems result from immaturity or irresponsible attitudes. Again, one should not make judgments solely on the basis of the credit record. One has to understand the whole person and the reasons for this record,

and only then judge the extent to which an individual's financial problems might constitute a security risk. If an individual with financial problems has shown a general propensity toward high-risk behavior and a contempt for authority, one might judge that this individual is more likely than others to turn to illegal or unethical means of solving financial difficulties.

Prevalence of Financial Problems

This section presents statistics on the amount of consumer credit outstanding in the United States and on delinquency rates for many kinds of financial obligations. It shows how common or uncommon various types of financial problems are. The problem of unexplained affluence is also discussed, although no statistical data is available on its frequency.

Overall Consumer Credit

The overall amount of consumer installment credit outstanding has increased from $356.5 billion in 1977 to $739 billion in 1990 (as of December, seasonally adjusted). With a little over 94 million households in the United States, this is an average consumer installment debt of about $7,850 per household. Consumer installment credit refers to credit extended to individuals that is scheduled to be repaid (or has the option of repayment) in two or more installments, excluding loans secured by real estate. It includes automobile loans, credit card accounts, and personal loans by banks, credit unions, savings and loans, and finance companies.

Figure 1 depicts this increase in consumer credit since 1977.[12] Inflation accounts for much of the increase. Even after adjusting for inflation, however, consumer installment credit increased by 43% from 1980 to 1988 and has continued to increase. By comparison, real disposable income grew by only 32% during this same period, indicating that debt grew faster than income. Almost all of the increase in debt came since 1983 during a period of economic growth and expansion.

There are several possible explanations for this apparent deterioration of family finances. The average length of a new car loan increased from 36 months to 48 months, which made it possible for car buyers to carry a larger loan balance with no increase in monthly payments. There was further proliferation of credit cards, partially as a result of heavy marketing to lower income and therefore higher risk groups.

On the other hand, the way these statistics are calculated masks what was actually an even larger increase in consumer debt. The Tax Reform Act of 1986 first reduced and eventually eliminated the tax deductibility of interest paid on consumer debt. This prompted many homeowners to take out home equity lines of credit, for which interest

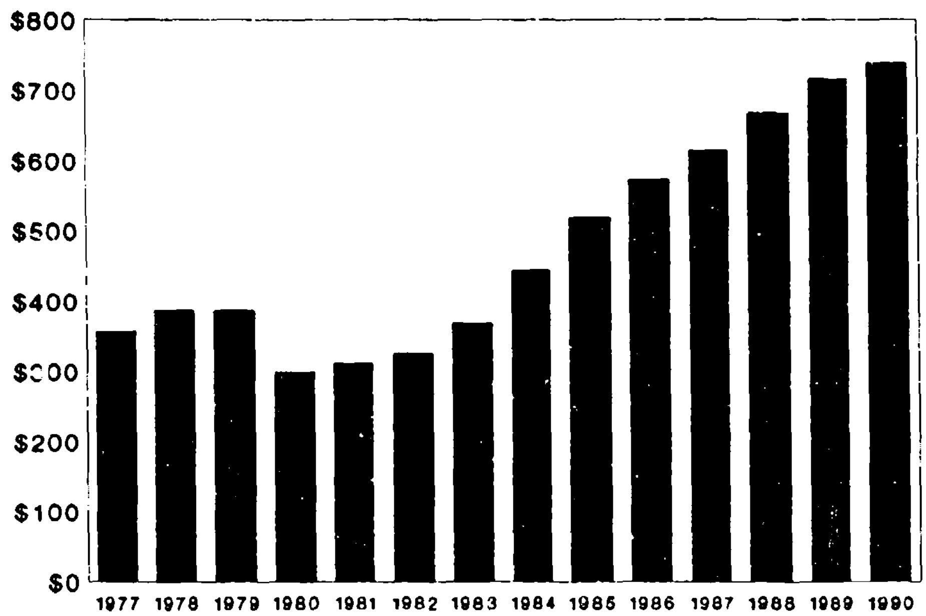

Figure 1. Consumer Installment Debt, in Billions of Dollars

As of December each year, seasonally adjusted, not adjusted for inflation.

payments are tax deductible. Since these lines of credit are secured by real estate, they fall outside the generally accepted definition of consumer credit. Surveys have shown that a substantial portion of the approximately $75 billion in home equity credit line balances outstanding at the end of 1988 was being used for things that would normally be considered consumer credit rather than home improvements.[13]

Consumer Credit Counseling Service (CCCS) is a non-profit organization that provided free or very low cost services to an estimated 390,000 families in 1990. As of January 1991, it had 578 offices in the United States and Canada and was growing at a rate of two new offices per week. Table 1 gives the results of a 1989 survey of CCCS clients concerning the reasons for their financial problems. This was not a carefully planned and conducted scientific survey, but it does give a very rough indication of the portion of those having financial problems who may not themselves be greatly at fault. Half of those receiving credit counseling reported that their problems were the result of unemployment, accident or disability, divorce or separation, unexpected medical expenses, or reduced income. The other half attributed their problems simply to "Overobligation" (47%) or "Other" (4%). The "Other" category included those who admitted drug abuse or gambling as the source of their problem.

Table 1

Reasons for Financial Problems

Overobligation	47%	Unexpected Medical	10%
Unemployment	13%	Reduced Income	1%
Accident/Disability	13%	Other (e.g., Drugs, Gambling)	4%
Divorce/Separation	12%		

Responses by Consumer Credit Counseling Service clients to 1989 survey.[14]

The "Overobligation" and "Other" categories cover problems that were caused by immaturity, irresponsibility, compulsive spending, gambling, drugs and alcohol. They amounted to about half of those receiving counseling services. Of course, the listing of unemployment, divorce, accident and medical problems may mask some compulsive behavior that contributed to or caused that problem. Therefore, the actual percentage of those whose financial problems are predominantly of their own making may be greater than 50%.

Bankruptcy

In 1990, eight-tenths of one percent of all households, or one of every 120 American households, filed for bankruptcy.[15] In the first quarter of 1991, personal bankruptcies jumped by 28% over the year-earlier level. The number of bankruptcy filings during the first quarter of 1991 was 213,093, up from 166,694 in the first quarter of 1990.[16]

The frequency of bankruptcy in the United States has been increasing dramatically since a new bankruptcy law went into effect in 1979. The new law lowered the cost to the individual filing for bankruptcy by increasing the number of assets that are exempt from liquidation in the bankruptcy process. During the decade of the 1970s, before the new law, there were a total of 2,086,189 bankruptcy filings. During the 1980s, this increased by almost two-and-a-half times to a total of 4,583,391 bankruptcy filings. This and other bankruptcy statistics in this section are from a March 1991 draft of the 1990 annual report on "Bankruptcy Statistical Information" prepared by the Administrative Office of the United States Courts, Division of Bankruptcy.[17]

Bankruptcy is not always bad. Many people experience financial problems through no fault of their own, and bankruptcy rules were loosened in 1979 for the express

purpose of making it easier for people to get a fresh start. To evaluate the significance of bankrupty, it is necessary to understand the reasons for it and what efforts were made to solve the financial problems short of bankruptcy.

There are two basic ways an individual can file for personal bankruptcy. Under Chapter 7 of the 1978 Bankruptcy Code, the procedure is based upon the value of the debtors' assets, less certain essential assets, such as a home, that are exempt. The non-exempt assets are sold by a court-appointed trustee to pay off unsecured creditors as much as possible. The remaining debts are then canceled. A Chapter 7 filing usually remains on a credit report for ten years and cannot be repeated for six years. About 70% of bankruptcy filings are made under Chapter 7. Of these, about 90% are "no asset" cases where all property of the debtor is exempt from sale by the court-appointed trustee.[18] In such a "no asset" case, all debts are wiped clean and the debtor loses no tangible assets.

Proceedings under Chapter 13 are based on the debtor's future earnings potential. This is designed for individuals with regular income who desire to pay their debts but are currently unable to do so. The primary benefit of Chapter 13 relief is the ability to consolidate debts and repay creditors, in full or in part, in installments over a three to five year period. During this time creditors are prohibited from collection efforts. The payments are supervised by a court-appointed trustee. Again, any remaining debts are canceled at the time the individual emerges from the bankruptcy proceeding. The record of the Chapter 13 filing remains in one's credit report for seven years.

Most business bankruptcies are actually counted as personal bankruptcies under Chapter 7 or Chapter 13. This is because most businesses are either sole proprietorships or partnerships where the individual is personally liable for the business debts. Corporations file for bankruptcy under Chapter 11 of the bankruptcy code, which allows a business to reorganize as a going concern rather than be liquidated. It provides the business with breathing room to scale down its operations and work out a plan of repayment acceptable to its creditors. Although Chapter 11 is well known because of the publicity surrounding the bankruptcy of large corporations, it is actually not very common. There were only 20,783 Chapter 11 cases during 1990. About 97% of all bankruptcies are personal bankruptcies.

The steady increase in bankruptcy filings during the 1980s is shown graphically in Figure 2. Almost all of this increase has been in personal bankruptcies, as business bankruptcies peaked in 1984 and have dropped significantly since then.

The fall in the number of bankruptcies during 1983 and 1984, as shown in Figure 2, is attributed to economic growth following back-to-back recessions between 1980 and 1982. The rapid growth in bankruptcies starting in 1985 has been called "the boom in going bust." This has puzzled economists because of the growth in consumers' disposable income during this same period. One factor may be that despite economic growth from

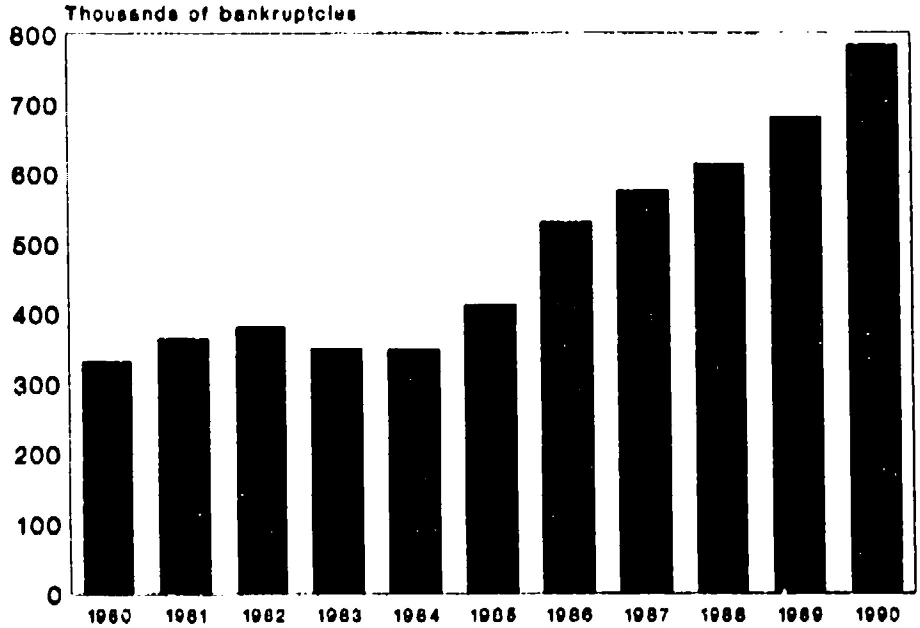

Figure 2. Bankruptcy Filings, All Types, in Thousands

1985 to 1990, the proportion of households carrying heavy debt loads increased, thus increasing the pool of potential bankrupts. Other factors may be changes in consumer attitudes toward bankruptcy (reduction in the social stigma of filing), the trend toward extending consumer credit to higher risk categories of borrowers, attorney advertising, and a wider awareness of the improvement in household finances that may be gained through filing for bankruptcy.[19]

There are great differences between the states in frequency of bankruptcy cases. These are caused mainly by differences in state laws on the amount and type of property exempt from bankruptcy proceedings. These determine how much an individual gets to keep after going through bankruptcy. At one extreme, Tennessee during 1990 had one bankruptcy filing for every 51 households, while at the other extreme, Hawaii had only one filing for every 409 households. Fourteen states had at least one bankruptcy for each 100 households, while ten states and the District of Columbia had less than one bankruptcy per 200 households. As previously noted, the national average in 1990 was one bankruptcy for every 120 households. Table 2 shows the number of households per bankruptcy filed during 1990 for each state plus the District of Columbia and Puerto Rico.[20]

Table 2

Number of Households per Bankruptcy

CALENDAR YEAR 1990

State	# of Households in 1000's	Total Cases Filed 1990	Households per case filed	Nat'l Rank	State	# of Households in 1,000's	Total Cases Filed 1990	Households per Case Filed	Nat'l Rank
TENN	1,882	36,718	51	1	TEXAS	6,134	43,279	142	27
GA	2,362	42,407	56	2	NEB	622	4,048	153	28
ALA	1,519	25,853	59	3	AK	180	1,153	156	29
UTAH	534	7,894	68	4	MONT	307	1,951	157	30
NEV	442	6,468	68	5	RI	376	2,345	160	31
ARIZ	1,303	18,385	71	6	NHAMP	413	2,568	161	32
COL	1,281	16,671	77	7	MICH	3,424	20,524	167	33
OKLA	1,250	15,233	82	8	MD	1,729	10,311	168	34
MISS	929	11,228	83	9	PR	1,210	7,082	171	35
IND	2,102	24,109	87	10	WISC	1,842	10,766	171	36
IDAHO	370	4,100	90	11	SDAK	271	1,492	182	37
ORE	1,127	12,091	93	12	NJER	2,858	15,405	186	38
KY	1,396	14,718	95	13	WVA	708	3,670	193	39
CALIF	10,581	108,607	97	14	IOWA	1,097	5,661	194	40
OHIO	4,148	39,689	105	15	NCAR	2,498	12,659	197	41
VA	2,274	21,590	105	16	NY	6,843	33,248	206	42
MINN	1,643	15,100	109	17	CONN	1,211	5,608	216	43
KS	965	8,811	110	18	MASS	2,235	10,154	220	44
WASH	1,867	16,425	114	19	DC	241	1,087	222	45
ILL	4,370	37,832	116	20	SCAR	1,245	5,527	225	46
LA	1,562	12,918	121	21	NDAK	247	1,082	228	47
WYO	177	1,424	124	22	DEL	250	1,088	230	48
ARK	912	7,062	129	23	PENN	4,538	17,871	254	49
NMEX	548	4,200	131	24	MAINE	469	1,809	259	50
MO	1,988	14,847	134	25	VT	216	701	308	51
FLA	5,072	36,552	139	26	HI	361	882	409	52
Nat'l	94,129	782,960	120						

Other differences between states are caused by regional changes in economic conditions. During 1990, for example, bankruptcy filings increased by about 15% nationwide, but they increased by at least 55% in each of the New England states which felt the brunt of an economic recession. During 1990, bankruptcy filings increased by 63.2% in Connecticut, 88% in Massachusetts, and 94% in New Hampshire. Massachusetts led the nation with a 403% increase in bankruptcy filings during the past five years. Even after this increase, however, Massachusetts still ranked only 44th among the states in the frequency of bankruptcies per 100 households.

To help lenders and businesses cope with the increasing frequency of bankruptcy losses, VISA recently initiated a Bankruptcy Alert Service. Subscription to this service provides information updated weekly on computer disk or tape of all bankruptcy filings anywhere in the United Sates.[21] This information could then be matched by computer against personnel records to gain prompt notification of cleared personnel who are having serious financial problems, and this computer matching could be done in-house with very little effort. The same information will eventually be available through a credit check when a periodic re-investigation is done, but it would only be received several years after the financial problem had come to a head.

Credit Cards

In 1988, more than $390 billion worth of goods and services were purchased with credit cards issued by banks, department stores, gas stations, and other retailers. This part of the credit industry has been growing at the rate of about 16% per year, and Americans now hold more than 880 million credit cards.[22]

The American Bankers Association reports that the delinquency rate on individual bankcard accounts grew from 2.56% of all revolving accounts in the third quarter of 1990 to 2.86% in the fourth quarter. This compared with 2.24% of revolving accounts in the fourth quarter of 1989. The percentage was higher when calculating the percentage of all outstanding balances, rather than the percentage of individual accounts. In the fourth quarter of 1990, 4.46% of outstanding bankcard debt was overdue by 90 days or more. That was up from 4.01% in the third quarter and 3.22% in the fourth quarter a year ago. This is the highest delinquency rate since the fourth quarter of 1986, when the rate was 4.8%.[23] When families start having financial problems, their unsecured credit card debt is among the first debts to go unpaid.

These delinquencies led Visa and MasterCard to write off a total of $5.19 billion as bad debts in 1990. This was 3.37% of their outstanding credit card balances, up from 2.99% in 1989.[24]

Two different types of sources provide information on patterns of credit card use. One is a series of five surveys of consumer finances sponsored by the Federal Reserve

Board between 1970 and 1986.[25] These figures are based on consumer responses to survey questions. The other source is collation of statistical data provided by companies that issue credit cards.

The Federal Reserve Board studies reported that just over half of all American families held one or more types of credit card in 1970. This increased to 71% of families surveyed in 1986. The greatest growth came from bank credit cards, which were held by only 16% in 1970 but 55% in 1986. Figure 3 shows the increase in percentage of families at various income levels that hold bank cards. The income levels for all years are expressed in constant 1985 dollars. One notes that 21% of all families with incomes under $10,000 had bank credit cards in 1986, and 37% of all families with incomes between $10,000 and $19,999. The greater the income, the greater the percentage of people having at least one bankcard.

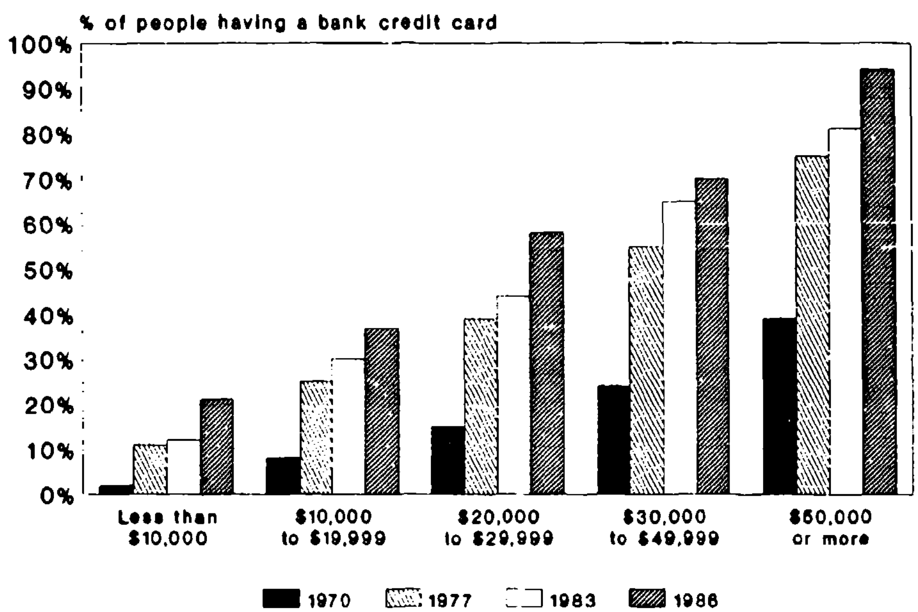

Figure 3. Growth in Bank Credit Cards, by Income
Income in constant 1986 dollars

Use of bank credit cards has continued to increase rapidly since 1986, as bankcard marketing programs have increasingly targeted the lower income and higher risk market segments of the population that did not previously use them. For example, the number of MasterCard holders in the United States increased from 71 million in 1986 to 90

million in 1990.[26] Current information on the percentage of bankcard holders by income level is not available.

Credit card holders may be divided into "convenience users" who pay the full bill each month so that no interest is accrued, and "revolvers" who use the cards as a source of credit and often pay only the minimum balance due. The Federal Reserve surveys asked families about their payment patterns. In 1977, 1983 and 1986, almost half of families using bank or retail credit cards said they "nearly always pay in full." Those reporting that they "sometimes pay in full" dropped from 28% in 1977 to 23% in 1986, with a corresponding increase in families who "hardly ever pay in full." The greatest increases in the "hardly ever pay in full" category were families with incomes less than $10,000, up from 19% to 41%; those aged 65 and over, up from 8% to 22%; and those with no more than an eighth grade education, up from 24% to 60%.

The percentage of convenience users who pay their full balance each month has been declining since the last consumer finance survey in 1986. Data provided by credit card issuers is not directly comparable to the Federal Reserve's survey data, but it offers a similar picture. According to a national association of bankcard holders, Bankcardholders of America, in 1986 about 50% of card holders paid their full balance every month and paid no interest. By 1990, this figure had dropped to 33%, with the remaining accounts carrying a balance for more than 30 days and therefore accruing interest.[27] The decrease in percentage of convenience users and corresponding increase in revolvers since 1986 is explained, at least in part, by the strategy of many card issuers to market their cards to lower income and higher risk segments of the market.

The figures vary for different types of bankcards. MasterCard reports that during the average month in 1990, 26% of its cardholders paid their account in full and were charged no interest; conversely, 74% carried over a balance for more than 30 days and were charged interest. This had changed from an average of 29% and 71% in 1986.

At MasterCard, the average monthly balance for those accounts that did revolve and accrue interest was $1,340 during 1990. The average payment per month on those balances was $179.98. This is the average for all types of cards; the figures would be higher for premium or "gold" cards issued to wealthier customers with a higher credit line and lower for regular cards.[28] This is comparable to a figure provided by Bankcard Holders of America that the outstanding revolving balance on all bankcards averages $1,600.[29]

In the fourth quarter of 1990, the average interest rate on bankcard debt was 18.23%, the highest since 1986.[30] At this interest rate, a debt will almost double in four years. Many issuers were charging as much as 19.8% interest.[31] However common it may be, continued maintenance of credit card debt at these interest rates is not good financial planning. At a time when other rates were moving down, credit card rates inched up as banks became concerned about increasing default rates. Cardholders seem

insensitive to the high rates as most intend to pay off their monthly balance to avoid the interest, even though many fail to do so.[32] Cardholder balances continued to grow even after 1986 when changes in tax law first reduced and then eliminated the tax-deductibility of consumer interest. In spring 1991, a few credit card issuers finally started to compete on the basis of lower interest rates.[33]

Other Consumer Credit

The American Bankers Association collects monthly data from a sample of commercial banks concerning the number of loan contracts of various types delinquent by 30 days or more. It then puts out a quarterly report called *Consumer Credit Delinquency Bulletin*. Unless otherwise noted, the information below is from the report for the first quarter of 1990.[34]

The ABA quarterly report includes a composite figure that is a weighted average of delinquency rates for seven types of closed-end consumer credit. These are unsecured personal loans, direct and indirect auto loans, mobile home and recreational vehicle loans, property improvement loans, and home equity loans that have a fixed payment schedule. Credit card debt is not included. Since 1977, this composite delinquency rate has ranged from a low of 1.78% in February 1984 to a high 2.86% in September 1989.

In March 1990, the composite delinquency rate was 2.46%. As usual, there was significant variation between states. Nebraska, Wisconsin and Arizona had the lowest delinquency rates, with 1.15%, 1.23%, and 1.26% respectively. North Dakota, Connecticut and Massachusetts were the highest at 5.59%, 5.36%, and 5.13%.

As might be expected, unsecured personal loans have the highest delinquency rate, with an average of 3.37% of such loans delinquent at least 30 days in March 1990. This figure varied from a low of 1.22% in Colorado to a high of 7.85% in Connecticut.

After home mortgages, automobile loans are the largest single source of consumer installment indebtedness. They account for roughly 40% of total non-mortgage installment debt. There are two types of automobile credit contracts, direct and indirect. Direct loans are made to customers who apply directly at the bank. Indirect loans are made through retail auto dealers to borrowers that the bank typically never sees. Delinquency rates on indirect loans are consistently higher than on direct loans, as the auto dealers do not screen borrowers as effectively as the banks.

Since 1977, the percentage of auto loans more than 30 days past due has ranged from a low of 1.32% to a high of 2.68%. In March 1990, the figure was 1.83% of direct loans and 2.30% for indirect loans. The highest delinquency rates for direct loans were in Puerto Rico (9.15%), North Dakota (5.58%), and New Hampshire (5.45%). For indirect loans, the highest rates were in Massachusetts (5.18%), North Dakota (4.14%),

and Alabama (3.92%). Notice that the *average* delinquency rate was lower for direct loans than for indirect loans, but the peak delinquency rates for individual states are for direct loans rather than indirect. One possible explanation is that auto dealers in those high risk states are more aggressive than banks in repossessing cars once the delinquency reaches 60 or 90 days.

Repossession of cars on indirect loans made by auto dealers is almost twice the rate for direct loans by banks. In March 1990, there were 1.81 repossessions for every 1,000 indirect loans outstanding, and only .94 per 1,000 direct loans. Those are monthly figures, so the annual rate of repossession would be about 22 per 1,000 or 2% for loans through an auto dealer and about 12 per 1,000 or 1.2% for bank loans.[35]

Repossession rates for leased automobiles are similar. Leased vehicles repossessed during 1990 represented 1.52% of the value of all auto leases outstanding. This was roughly double the year-earlier figure. The Consumer Bankers Association suggests that repossessions increased dramatically because consumers struggling to afford higher priced new cars increasingly turned to leasing when they found they could not afford to buy.[36]

Mortgages

Mortgage loans are the largest source of household indebtedness. Mortgage payments past due reached a peak in the third quarter of 1990 when 5% of all mortgage payments on one to four-unit residences were past due. Of these, 3.47% were 30 days past due, .78% were 60 days and .75% were 90 days or more past due. Foreclosures were started on .33% of all loans.[37] From 1977 through 1988, the delinquency rate had ranged from 3.12% to 4.15%.[38] During 1989 through the third quarter of 1990, however, the rate ranged from 4.41% to 5%.

According to the quarterly *National Delinquency Survey* prepared by the Mortgage Bankers Association, delinquency rates vary substantially depending upon type of mortgage loan. Although the average during the third quarter of 1990 was 5%, the rate for conventional loans was 3.23%, for VA loans it was 6.81%, and for FHA loans it was 7.06%. Figure 4 shows the rate for these various types of loans broken down by the length of time past due.

Delinquency rates also vary by state, with some states having twice as many delinquencies as others. Regional economic conditions and differences in foreclosure laws and practices affect which states have the highest rate. States with particularly high rates during 1990 were Mississippi, Tennessee, Louisiana, Texas, and New Mexico. States with the lowest rates were Hawaii, South Dakota, Oregon, and Washington.

Second mortgages and open-ended home equity loans have lower delinquency rates. According to the American Bankers Association *Consumer Credit Delinquency Bulletin*,

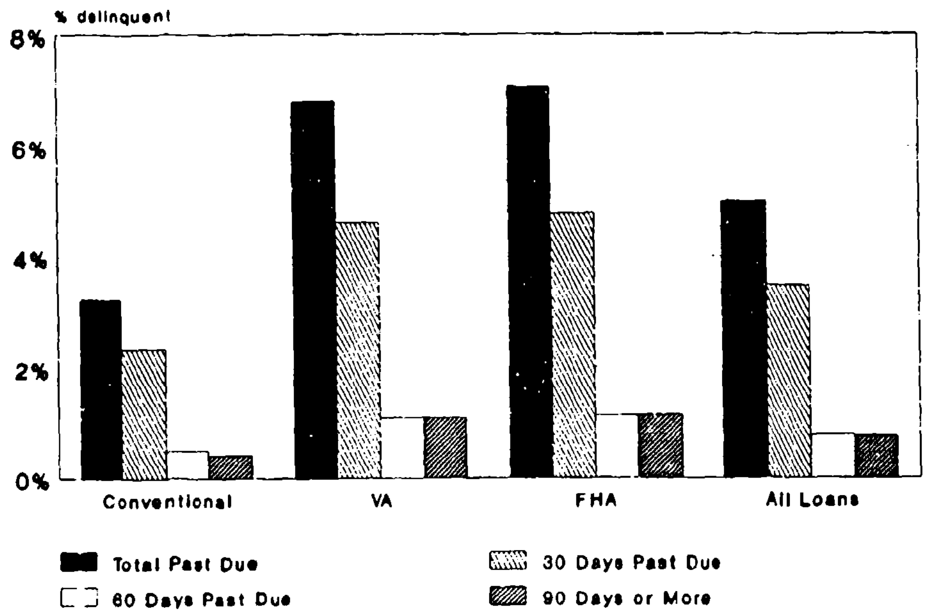

Figure 4. Residential Mortgage Delinquencies, 1990 3rd Qtr.

1.47% of second trust loans with a fixed payment schedule were past due 30 days or more as of March 1990. For the open-ended home equity loans, the rate was .79%. Demand for home equity loans has grown rapidly since the 1986 tax law changes. In early 1991, home equity lending was running 18% above the year-earlier level. About 20% of all homeowners now have home-equity lines of credit.[39]

Income Taxes

The Internal Revenue Service estimates that about 6 to 7 million Americans who owe tax fail to file federal income tax returns. About 110 million individual tax returns are filed each year, so this represents a startling failure-to-file rate of roughly 5.5%. The estimate of 6 to 7 million non-filers is not a hard figure, as this is obviously a difficult subject to research. The current estimate is based on an old, 1977 IRS study that has been updated only to reflect the increased number of persons filing returns.[40]

As noted previously, a check of IRS master file records (not the individual Form 1040 files) on 44 Americans arrested for espionage since 1980 found that 13 to 17 (29.5% to 38.6%) of them failed to file an income tax return during at least one year prior to

their arrest. The exact number is uncertain, as in four cases it was not clear whether the individual actually owed tax during the year in question.

Failure to file an income tax return is a potential disqualifying factor for a security clearance, as an individual who does not respect the U.S. Government's tax laws cannot be counted on to have much respect for security regulations. Failure to file a tax return is easier for a self-employed person to get away with than for a government or other employee whose salary is subject to tax withholding. However, failure to file occurs even among government employees, especially those whose financial situation is in considerable disarray. It is noteworthy that failure to file is only a misdemeanor, while intentionally giving false information on a return is a felony. If one cannot pay the tax or does not want to disclose certain income, the penalty is less severe for not filing at all than for filing a deliberately false return.

Of the roughly 110 million tax returns that were filed in 1989, about 14%, or 15.5 million, were assessed a penalty. There were 9,524 penalties for fraud, 226,708 for paying with a check that bounced, 1.6 million penalized for delinquency (late payment or failure to file), 1.8 million penalized for negligence; 4 million penalized for failure to pay estimated tax, and 7.7 million penalized for failure to pay (underreporting of income such as failure to report an interest payment). There were also 94,307 penalties for other offenses such as using an incorrect taxpayer identification number, failure to report tips, and incorrect reports of amount withheld.[41]

Student Loans

About 17% of borrowers in the federal guaranteed student loan program were in default during 1990, and these defaults cost the federal government $2.4 billion during that year.[42] The default rate for students who had attended four-year colleges was 10%, for those from two-year schools it was 20% to 25%, while students from trade schools defaulted at a 39% rate.[43]

In 1990, the Department of Defense obtained a computer tape of all student loan defaulters and matched this tape against its computer records of 10 million current and retired military and federal civilian employees. This kind of computer matching can be done very quickly, in-house, and with relatively little effort. The computer match determined that 65,598 defaulters who owe the U.S. Government $184.5 million were then receiving a U.S. Government paycheck. This means that out of every 1,000 current and retired federal civilian and military employees, about 6.6 are in default on student loans.[44]

Default of federal guaranteed student loans may indicate either financial problems or lack of respect for financial obligations or for government regulations.

Child Support Payments

In 1985, there were 8.8 million women with children under 21 where the father was not present in the household. Of these 8.8 million women, 61% had been awarded child support and 39% had not. Of those awarded child support, only 48% were receiving the full amount. Less than the full amount was received by 26%, and another 26% received nothing.

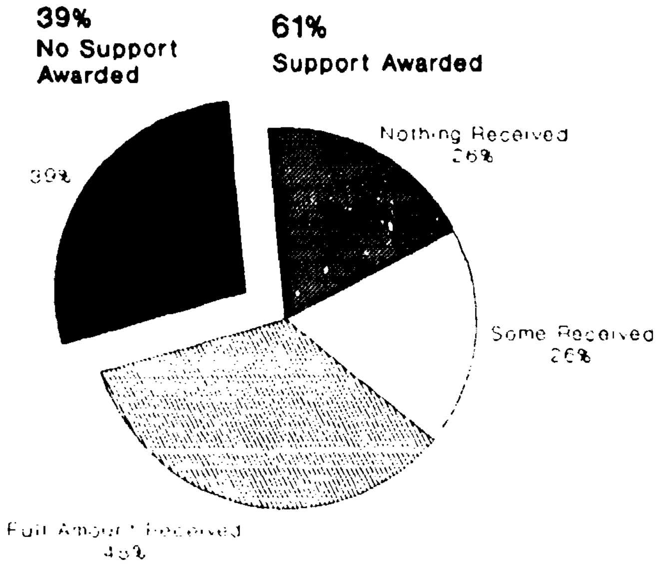

Figure 5. Child Support Payments, 1985

In other words, more than half of the fathers ordered to make child support payments were either delinquent in these payments or completely ignored the order. The problem of child support payments has been increasing due to the steady increase in number of single-parent families.

Failure to pay child support costs federal and state governments large amounts of money, as many single mothers must then depend upon Aid to Families with Dependent Children (AFDC) and other welfare programs. In order to place the burden for child support on the parents, where it belongs, Congress in 1975 established the Child Support Enforcement Program, which is implemented by the states under federal policy guidelines and standards and with largely federal funding.

During FY 1988, the Child Support Enforcement Program collected $4.6 billion. Of this amount, $1.5 billion was collected on behalf of families receiving AFDC payments, and much of this was used to offset the AFDC payments. Elements of the federal enforcement program include intercepting federal income tax refunds, helping establish paternity and getting support orders issued, operating the Federal Parent Locator Service, encouraging states to report child support information to credit bureaus, and changing the law to allow states to withhold wages and impose liens on property for overdue child support.

The enforcement program also includes ability to match a computer tape of non-payers against an agency's computer records of its own employees. A 1989 computer match identified 53,670 active, retired or reserve military or civilian Defense Department employees who are not meeting their child support obligations.[45]

In addition to the costs it imposes on government and society at large, failure to pay child support is a relevant factor in security clearance because it indicates either an inability or refusal to accept responsibility for the consequences of one's actions.

Pawnbrokers

Pawnbrokers provide credit to the approximately 10% of the population that is excluded from the mainstream credit markets. The Federal Reserve Board's 1983 Survey of Consumer Finances found that 12% of all families did not have a checking or savings account, almost guaranteeing that they would not pass the typical screening requirements of a bank or finance company. These tend to be persons with low incomes and little education, and their only access to credit may be the pawnbroker. Some pawnshop customers have access to traditional forms of credit but select the pawnshop for its privacy and discretion.

Default rates on pawnbroker loans are high. Depending on the state, they range from 14% to 22% of all loans made. Given the exceptionally high cost of patronizing pawnbrokers in most states, seeking out this source of credit often indicates some measure of desperation. Either the individual's financial condition is so weak that there is no other alternative, or, for some reason, the individual is willing to pay dearly for the increased privacy associated with pawnbroker transactions.

There are roughly 6,900 pawnshops in the United States, one for about every 35,700 inhabitants. They are most common in the Southern and Central Mountain states, with the greatest density of pawnshops found in Oklahoma and Texas. Pawnbrokers made about 35 million loans in 1988. They serve several million Americans each year and perhaps as much as 10% of the adult population. The average loan is only $50, but repeat customers are common. Effective interest rate ceilings vary across states from 1.5% per month to 25% per month. In more than half the states, pawnshops

levy interest rates and fees that on an annual basis amount to 120% APR or more for an average-size loan. If a customer defaults, the collateral becomes the property of the pawnshop after a specified period, commonly one to three months. The amount loaned is typically 50% to 60% of the resale value of the collateral.[46]

Unexplained Affluence

Unexplained affluence refers either to known income from unidentified sources or to a pattern of expenditure and standard of living that cannot be explained by known sources of income. No statistical data is available on unexplained affluence.

Unexplained affluence is a difficult concept to work with, as there are so many legal as well as illegal sources of income beyond one's own salary. Unusual affluence might come from inheritance, gifts from parents, astute investments, a profitable hobby, or a second job. On the other hand, it may also be attributable to drug dealing, espionage, or other criminal activity. In many cases, the indications of affluence are the same regardless of its source.

Indicators that investigation of unexplained affluence may be appropriate include large cash transfers, paying in cash (especially large denomination bills) for purchases that are more normally paid for by check or credit card, foreign bank accounts, any apparent attempt to hide income, or sudden changes in financial status. Title 31 of the Bank Secrecy Act provides for maintenance by Customs and/or the Internal Revenue Service of five data bases that are relevant to detection of unexplained affluence. These data bases are records of bank, merchant, and casino currency transaction of $10,000 and over; international transportation of currency or financial instruments with a value of $10,000 and over; and foreign bank accounts. All are retrievable from one consolidated data base at the IRS Detroit Data Center.

Indicators of Financial Problems

This section provides background information for those whose job involves identifying the presence of financial problems and judging how bad they are. It addresses questions such as: How much debt is too much? How accurate are credit reports, and what is often missing from them? What is credit scoring, and how is it used? This section also discusses compulsive gambling and compulsive shopping, as these common causes of financial problems are often overlooked.

The Debt Test

A principal rule of thumb used by credit counselors is that if an individual's monthly payments for consumer credit (excluding mortgage but including car payments) are more than 20% of monthly take-home pay, that individual is in serious trouble. A 1981 study of persons filing for bankruptcy found that 91% of bankruptcy filers failed this 20% test. Within the general population, only 5% are this burdened with consumer debt. The bankruptcy study found that this debt/income ratio is the single most useful predictor of who will file for bankruptcy.[47]

The National Foundation for Consumer Credit, which is the umbrella organization for 578 Consumer Credit Counseling Service offices in the United States and Canada, has developed a simple test to help consumers know when they should become concerned about their debt levels. If a person answers yes to two or more of the following questions, the NFCC says that person should seek professional assistance. The questions are:

1. Are you borrowing to pay for items you used to buy with cash?

2. Is an increasing percentage of your income going to pay debts?

3. Is your savings cushion inadequate or nonexistent?

4. Can you only make minimum payments on your revolving charge accounts?

5. Are you near or at the limit on your lines of credit?

6. Do you take out a new loan before the old one is paid off, or make a new loan to pay off the old loan?

7. Are you unsure about how much you owe?

8. Are your monthly credit bills more than 20% of your net income (excluding rent or mortgage)?

9. If you lost your job, would you be in immediate financial difficulty?

Credit Reports

A credit report is available on virtually all persons processed for security approval and is the most basic document for judging a person's financial status. Given its pervasive use, it is unfortunate that the credit report is so often incomplete or inaccurate. A 1989 study of 1,500 credit reports found that 10% of the reports contained some

information that applied to the wrong person, and that 43% contained errors of a nature that delayed processing of mortgage loan approvals.[48]

In early 1991, the Federal Trade Commission reported that credit reports are the No. 1 subject of consumer complaints, ahead of auto defects and debt collectors. In July 1991, the attorneys general in six states filed lawsuits against TRW, Inc. charging that it uses sloppy procedures that create errors in consumer credit files, inadequately investigates consumer complaints about inaccuracies, and allows errors to recur in consumer files. The attorneys stated that the same failings are apparent in the work of the two other major credit report vendors. In summer 1991, Congress was considering five bills to overhaul the industry.[49]

The credit report contains information on credit card debt, car loans, bank and finance company loans, most mortgages, and debts owed to many mail order firms and large department stores. Federal government programs are increasingly causing student loan information and child support obligations to be included. The credit report also has information from credit agencies on collection actions, repossessions and garnishment of wages. From public records it has information on most bankruptcies, liens, and civil judgments. The reports do not always have all relevant information, and the degree of completeness varies for the different categories.

Many items of interest do not generally appear on the credit report. Debts owed to local stores do not appear unless they have been turned over to a collection agency. Federal and state tax delinquencies are usually not reported. Doctors, dentists and utility companies do not normally report their bad debts. Alimony obligations are not reported unless there has been a court order to pay. Automobile or other equipment leases are not included.

Credit Scoring

Credit scoring is a computerized, mathematical procedure that most financial institutions now use to make decisions to accept or reject credit or loan applicants. There are many different versions of credit scoring, but what they all have in common is that they assign numerical weights or values to applicant characteristics such as age, income, occupation, length of credit history, level of indebtedness, home ownership, residential ZIP code, etc. One company that developed a bankruptcy forecasting model studied more than 300 potential characteristics before identifying what it considered 25 key indicators.[50] Other credit scoring systems are based on seven to ten key indicators. Several generic types of credit scoring models are discussed in the literature,[51] but the specifics of which variables are considered most important and how heavily they are weighted is carefully guarded proprietary information.

The weights assigned to each characteristic are based on the financial institution's past credit experience, for example experience that persons under age 30 are more likely to default on a loan than persons over 30. Weights assigned to all the relevant characteristics of each applicant are then summed to arrive at a score for that individual. The score is compared to an established standard to determine whether the applicant is approved, rejected, or subjected to further investigation or analysis.

Credit scoring aims to speed up the credit decision process and to increase its reliability and validity. It replaces or augments the judgment of loan officers with a pre-formulated decision process. It is done by computer and saves the human effort required to evaluate and make decisions on individual cases.

All three national credit report vendors are able to process all their credit records through credit scoring models. For example, TRW has a Bankruptcy Model and a National Risk Model. The Bankruptcy Model uses 13 variables that were identified as the most predictive characteristics in distinguishing between bankrupt and non-bankrupt consumers. These variables include debt burden, delinquencies, and number of inquiries about that account. For each consumer, the model calculates the risk that the individual will go bankrupt, have debts charged off for nonpayment, or have debts that become 60 or 90 days delinquent. The National Risk Model uses 43 behavioral characteristics to predict the risk of serious delinquencies in an account.

The output of each model is a number for each individual that reflects the degree of credit risk associated with that individual's credit history. The credit reporting vendors charge a small extra fee for including these credit scores on a credit report, so they are not included on all reports. Two of the vendors (TRW and Trans Union) also have an account monitoring service that alerts a lender whenever one of its clients reaches a given risk threshold specified by that lender.[52]

Payment of Old Debts

Individuals sometimes claim that they fully intend to pay their overdue debts. If they do pay them, this is certainly to their credit, but the evidence suggests that they often will not. The general rule is that the longer a bill is overdue, the less chance that it will ever be paid. The Commercial Collection Agency Section of the Commercial Law League of America did a survey to determine exactly how much the likelihood of payment diminishes as the debt becomes older. For a bill six months old, they found a 57.8% chance of successful collection. For a 12 month old debt, this dropped to 26.6%, and for 24 months to 13.6%.[53] This is shown graphically in Figure 6. These figures apply to debts that are being actively pursued by collection agencies. If the debt is not being actively pursued, the chances of payment are far less.

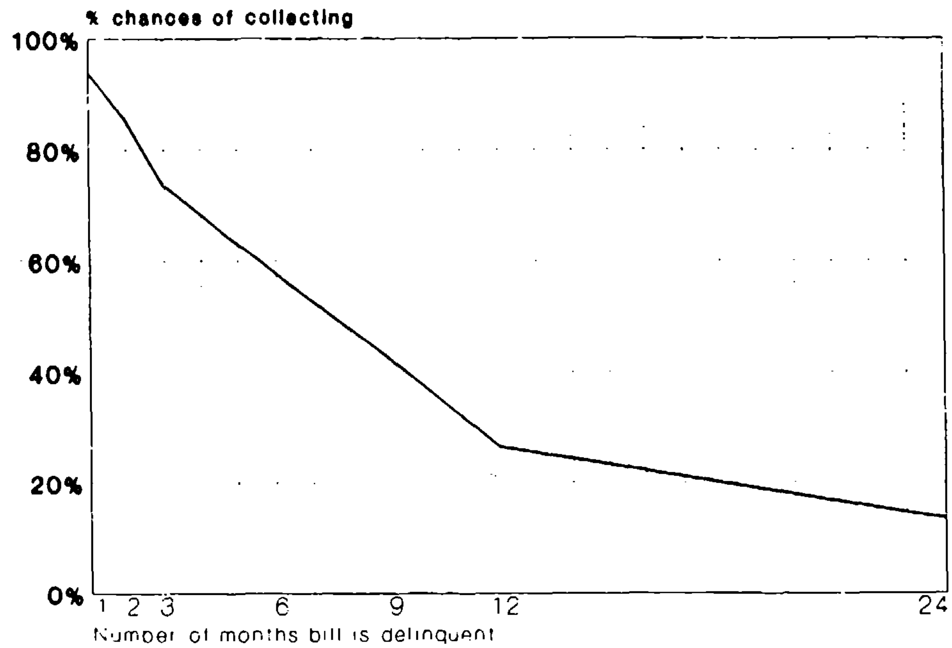

Figure 6. Chances of Collecting an Overdue Bill

Lack of Health Insurance

Health insurance is fundamental to sound financial planning, as extended hospitalization or disability that is not compensated by insurance can destroy one's financial well-being. Lack of health insurance could be the inevitable consequence of very inadequate income, or it may indicate immature, high-risk financial behavior. It is very common, however. If clearance is granted and an individual is employed by the government or a government contractor, health insurance will normally become available.

According to the 1990 census, 34 million Americans, or 16% of the non-elderly population, have no health insurance. Census figures show that 36% of Hispanics, 22% of blacks and 12% of whites lack health insurance.[54] Based on 1986 figures, about 75% of those without health insurance were employed or were family members of someone who was employed. About 90% of those who were employed but uninsured worked for employers not offering health insurance, mostly in the service sector. At least one-third of the uninsured group were families with incomes greater than twice the poverty line.[55]

As noted earlier in this section, 10% of Consumer Credit Counseling Service clients cited unexpected medical bills as the cause of their financial problems. A study of bankruptcy petitioners, however, found that less than 2% of bankruptcy filings by individuals are caused by overwhelming medical debts.[56]

Compulsive Gambling

Various patterns of compulsive behavior center around the theme of money--either spending it, saving it, or taking risks with it. These include compulsive gambling, shopping, hoarding, and "revenge spending" by an angry retaliatory spouse.[57] Compulsive gambling is so important, and so much information is available, that it will be discussed in greater detail in a separate report.

Briefly, opportunities for legal gambling are increasing dramatically. The amount of money wagered in the United States increased by 1,400% from 1974 to 1989, and the state lotteries represent only a small part of this increase.

Surveys of persons living in states where gambling opportunities are readily available found that the number of compulsive gamblers ranged from 1.2% of the adult population in California to 2.3% in Massachusetts. Another 2% to 3% were classified as problem gamblers; although not compulsive, their gambling did affect their family, work, or financial condition. In a state such as Iowa, where gambling has not been readily available until recently, the figure was much lower--0.1% compulsive gamblers and 1.6% problem gamblers.[58]

Several studies have shown that about two-thirds of members of Gamblers Anonymous and patients being treated for compulsive gambling admit to engaging in illegal behavior to finance their gambling or to pay gambling-related debts.[59] Of male members of a Gamblers Anonymous group, 47% admitted to engaging in insurance-related fraud or theft. The average dollar amount per person of the fraud or theft was $65,468.[60] Given this level of debt and crime attributable to compulsive gambling, it becomes a significant security issue.

Compulsive Shopping

Compulsive shopping is a potential cause of financial troubles. Statistics on its frequency are not available, although it is not uncommon. All compulsive shoppers don't have financial problems, however, as this emotional disorder affects the wealthy as well as those with limited means.

Like alcoholism, compulsive shopping is taking an otherwise common behavior to the extreme. This emotional disorder has been described as

> ... an overpowering urge to buy items, especially clothing, usually in a pattern of 'shopping binges.' The articles are not bought because they are needed or a bargain, or even out of an intrinsic desire for the thing itself. The urge, at its most intense, is a compelling desire to obtain items and is experienced as frantic and irresistible.... The distinction between compulsive shopping and the

occasional shopping 'spree' is that compulsive shopping represents an attempt ... to remedy depression and emptiness and is a chronic pattern. The compulsive shopper often experiences an inner tension that is released only when something is bought.[61]

Relationship of Financial Issues to Other Problem Behaviors

Financial issues may be related to other behaviors of security concern in either of two ways. Problems such as compulsive gambling, compulsive shopping, drug use or alcohol abuse may help cause financial problems by draining financial resources or contributing to poor health, divorce, or unemployment. Causation may also work in the opposite direction; the stress of financial problems may exacerbate drug or alcohol abuse or emotional problems or lead to criminal actions in a desperate effort to meet financial needs.

Crime

When financial need is a stimulus to crime, the nature of that crime may take many different forms depending on the opportunities available. Robbery, drug dealing and shoplifting are among the possibilities. The FBI's Uniform Crime Reports identify 29 different categories of crimes. Three of these are commonly regarded as financial crimes. The white-collar crimes of embezzlement, forgery/counterfeiting, and fraud are often committed by persons in a position of trust who find themselves in a financial bind or who fall to the temptations of an extravagant lifestyle well beyond their means. Espionage is a similar white-collar crime where a person misappropriates information rather than money.

Financial crimes are discussed in this report, as well as in a separate report on crime in general, because these crimes are often motivated by financial difficulties or by the temptations to which those in positions of financial trust are exposed. These crimes are defined as follows:

Embezzlement: Misappropriation or misapplication of money or property entrusted to one's care, custody, or control.

Forgery/Counterfeiting: Making, altering, uttering, or possessing, with intent to defraud, anything which is made to appear true.

Fraud: Fraudulent conversion and obtaining money or property by false pretenses. This includes confidence games, writing bad checks, giving or taking bribes, making

a false insurance claim, or deliberating giving false information on a tax form or travel voucher.

The FBI's Uniform Crime Reporting Program collects statistical information from approximately 16,000 city, county and state law enforcement agencies. It uses this information to compile an annual report entitled *Crime in the United States*. The information below is from the report for the year 1989.[62]

It is estimated that 18,200 persons were arrested for embezzlement, 105,400 for forgery or counterfeiting, and 376,600 for fraud in the United States during calendar year 1989. To facilitate comparison of arrest rates by region, age group, sex or race, arrests rates are commonly presented as number of arrests per 100,000 persons. There were 6.5 arrests for embezzlement per 100,000 inhabitants, 40.5 arrests per 100,000 for forgery and counterfeiting, and 145 per 100,000 for fraud.

Breaking arrests down according to the region of the country in which they occur shows some interesting patterns. Robbery, for example, is about twice as common in the Northeastern states as in other parts of the country, while motor vehicle theft is far more common in the Western states than elsewhere. The financial crimes of embezzlement, forgery and counterfeiting, and fraud are reported far more often in the South (which includes Washington, D.C.) than in other parts of the country. This is not because of a generally higher crime rate in the South; rather, there seems to be some special affinity for these crimes, as distinct from other types of crimes, in the South. Figure 7 shows the regional distribution of these crimes per 100,000 population.

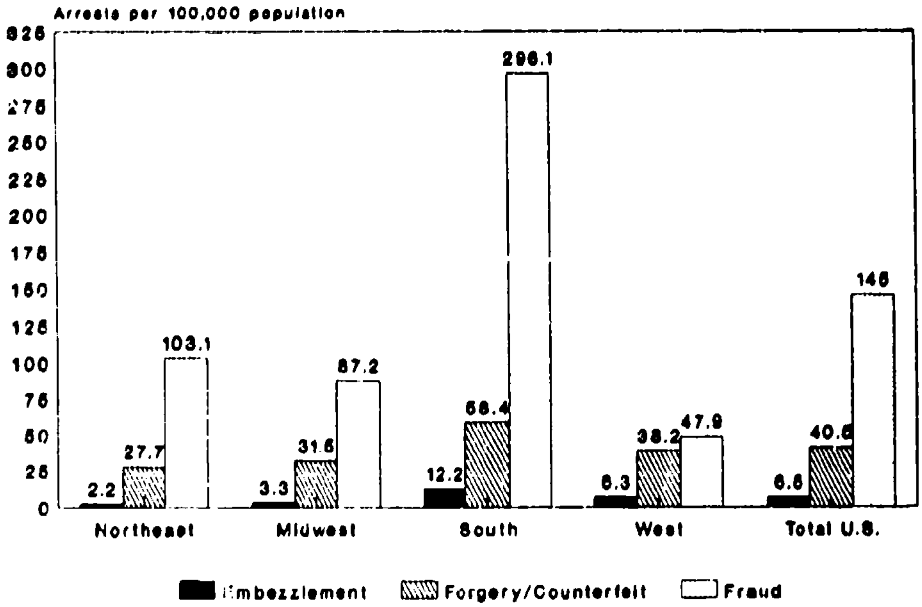

Figure 7. Financial Crimes by Region

For some reason, these financial crimes are reported more often in cities with a population between 100,000 and 250,000 than in either larger cities or smaller cities. Again, this is uniquely characteristic of these financial crimes; other crimes do not follow this same pattern. Figure 8 compares the rate per 100,000 inhabitants for cities ranging in population from 50,000 up.

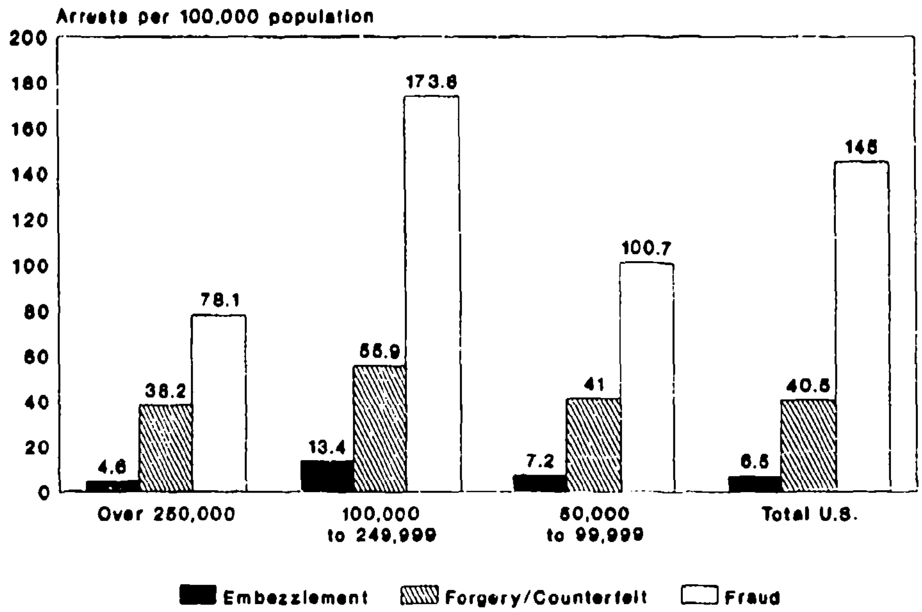

Figure 8. Financial Crimes by Size of City

Reports of arrests for financial crimes have increased at a faster rate than reports of arrests for other crimes. Reports of all arrests increased by 27.7% from 1980 to 1989. Arrests for embezzlement increased by 80.6% during this period, while forgery and counterfeiting increased by 21% and fraud by 20.8%. There was a dramatic increase in the number of women committing these crimes, presumably reflecting the changing role of women in the work force. Embezzlement increased by 52.8% among men and 151.7% among women. Forgery/counterfeiting and fraud increased by 16.2% and 13.2%, respectively, among men, but 31.8% and 31.5% among women.

Although 81.9% of all arrested persons were male, and only 18.1% female, females played a much larger role in financial crimes. In fact, more than one-third of reported financial crimes were committed by women, which is a greater percentage than for any of the 29 crime categories except prostitution and juvenile runaways taken into protective custody. The exact percentages are shown in Figure 9.

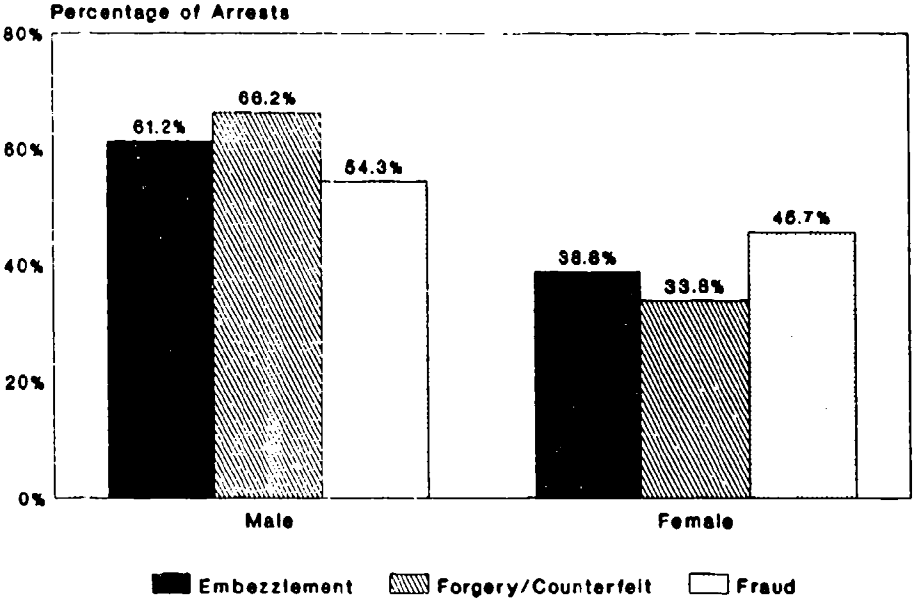

Figure 9. Financial Crimes by Gender

As with most other crimes, reports of financial crimes were most common among those age 25 to 34, with a pattern of gradually decreasing frequency in the older age groups. The breakdown by race was not much different than the distribution of all arrests, which was 67.3% white and 30.8% black.

Compulsive Behaviors

Compulsive gambling and compulsive shopping, either of which may cause financial difficulties, are often found together with other compulsive behaviors. One psychiatrist has noted, for example, that most compulsive shoppers he has treated have also suffered from some eating disorder, usually bulimia.[63] A study of Gamblers Anonymous members found that 52% also evidenced problems with alcohol or substance abuse.[64] A study of female compulsive gamblers found that 54% had been dependent upon something else (alcohol, drugs, overeating, overspending, sexual addiction) at some point in their lives.[65]

Compulsives of all types are engaged in an unceasing pursuit of ways to fill some inner emptiness or to relieve tension or anxiety. They may turn to alcohol, drugs, sex, food, gambling, or impressive possessions as means of satisfying some deep-seated psychological need. Compulsive behavior that affects one's financial condition, work performance or relationships with others often prompts denial of security clearance because of the intractable nature of the underlying problem. Behavior that is out of control can compromise an employee's dependability.

Mitigating Factors

If an individual has obtained or is obtaining help for a financial problem, this may be considered as a mitigating factor. Bankruptcy proceedings are one common way of resolving financial problems. The bankruptcy law is intended as a means of allowing people to make a fresh start. The question adjudicators must ask is whether an individual has indeed made a fresh start, or if the person has simply been relieved of past debt while retaining bad habits that caused that debt in the first place.

If the original problem was caused by compulsive spending, compulsive gambling, drug addiction, or alcoholism that caused unemployment, the fresh start accorded by bankruptcy may do little to alleviate the root cause of the problem, and future problems might be anticipated. On the other hand, if the original problem was caused by inexperience and immaturity, health problems, or loss of employment through no fault of the individual, past bankruptcy may be irrelevant to a current security evaluation.

Other mitigating factors may include credit counseling, participation in a debt repayment program, or participation in programs such as Debtors Anonymous or Gamblers Anonymous. Unfortunately, no hard data are available on effectiveness of these programs, on drop-out rates, or how much time must elapse before one can be confident the problem is under control.

The Consumer Credit Counseling Service reports that about 30% of its clients were able to help themselves after receiving budget counseling services, 37% required a debt repayment program, and the remainder were referred to other resources (lawyers or programs for treating compulsive behavior) or decided not to participate at that time. In the debt repayment program, CCCS makes arrangements with creditors to reschedule payments; the consumer then makes a single monthly payment to CCCS, which in turn pays creditors according to the arranged plan. In the CCCS experience, most individuals who start the debt repayment plan complete it successfully, and the recidivism rate is low. The average CCCS client has eleven creditors, total consumer credit debt of $16,548, and gross monthly income of $1,840.[66] Many other organizations or individuals offer similar credit counseling services.

Conclusions

The financial motivation evident in recent cases of Americans arrested for espionage has heightened awareness of the importance of financial issues when adjudicating security clearances. This comes at a time when more Americans are assuming larger amounts of debt which puts them at risk in the event of unanticipated financial obligations or loss of income. It also comes at a time when some observers of American values perceive an erosion of the personal values of honesty and loyalty to employer.

The frequency of personal bankruptcy has been increasing sharply for the past 12 years. During 1990, one in every 120 American families filed for bankruptcy, and the rate of bankruptcy filings jumped by an additional 28% in the first quarter of 1991. The Internal Revenue Service estimates that 6 to 7 million Americans who owed income tax failed to file a federal tax return in 1990. This is a failure-to-file rate of roughly 5.5%. In the latter part of 1990, 5% of all home mortgage payments were overdue, and the delinquency rate was about 7% for government-sponsored VA and FHA loans. About 17% of borrowers in the federal guaranteed student loan program defaulted on their loans in 1990.

These are very disturbing figures which confirm the need for careful investigation of financial issues. Experience suggests that financial difficulties may increase temptation to commit illegal or unethical actions. One must remember, however, that many such acts are committed out of simple greed, not need, and that the great majority of those with financial difficulties are not inclined to commit illegal acts at all. When investigating and adjudicating financial issues, it is important to look beyond the obvious facts of an individual's financial obligations. Investigators need to examine the causes of financial problems and how the individual has reacted to these problems.

Appendix

Adjudication Criteria

Adjudication criteria are set forth in Director of Central Intelligence Directive No. 1/14, "Minimum Personnel Security Standards and Procedures," dated 14 April 1986. These guidelines are used by the Central Intelligence Agency, while the Department of Defense has supplemented the DCID 1/14 guidelines with more specific standards in DoD 5200.2-R. The following paragraphs provide direct quotes from the DCID 1/14 guidelines and the more specific DoD 5200.2-R standards concerning financial irresponsibility.

DCID 1/14 Financial Irresponsibility Guidelines

Financial irresponsibility represents a serious concern to the SCI adjudicator. Persons who have engaged in espionage for monetary gain demonstrate the hazard of granting SCI access to an individual with overly expensive tastes and habits or living under the pressure of serious debt.

A recommendation for disapproval is appropriate when there is a pattern of financial irresponsibility and it appears that an individual has not made a conscientious effort to satisfy creditors. In such cases, the adjudicator should determine whether the individual had been notified about the debts and whether they were legally valid or ultimately satisfied.

When the financial irresponsibility alone is not of such magnitude to warrant disapproval, it may contribute to recommendation for denial of SCI access when there is other evidence of irresponsibility.

DoD 5200.2-R Financial Standards

Basis: Excessive indebtedness, recurring financial difficulties, or unexplained affluence.

Disqualifying Factors: (Behavior falls within one or more of the following categories):

1. History of bad debts, garnishments, liens, repossessions, unfavorable judgments, delinquent or uncollectable accounts or debts written off by creditors as uncollectable losses with little or no apparent or voluntary effort by the individual to pay amounts owed.

2. Bankruptcy:

a. Due to financial irresponsibility, or

b. With continuing financial irresponsibility thereafter.

3. Indebtedness aggravated or caused by gambling, alcohol, drug abuse, or other factors indicating poor judgment or financial irresponsibility.

4. A history or pattern of living beyond the person's financial means or ability to pay, a lifestyle reflecting irresponsible expenditures that exceed income or assets, or a history or pattern of writing checks not covered by sufficient funds or on closed accounts.

5. Indication of deceit or deception in obtaining credit or bank accounts, misappropriation of funds, income tax evasion, embezzlement, fraud, or attempts to evade lawful creditors.

6. Indifference to or disregard for financial obligations or indebtedness or intention not to meet or satisfy lawful financial obligations or when present expenses exceed net income.

7. Unexplained affluence or income derived from illegal gambling, drug trafficking or other criminal or nefarious means.

8. Significant unexplained increase in an individual's net worth.

Mitigating Factors: (Circumstances which may mitigate disqualifying information):

1. Scheduled program or systematic efforts demonstrated over a period of time (generally one year) to satisfy creditors, to acknowledge debts and arrange for reduced payments, entry into debt-consolidation program or seeking the advice and assistance of financial counselors or court supervised payment program.

2. Change to a more responsible lifestyle, reduction of credit card accounts, and favorable change in financial habits over a period of time (generally one year).

3. Stable employment record and favorable financial references.

4. Unforeseen circumstances beyond the individual's control (e.g., a major or catastrophic illness or surgery, accidental loss of property or assets not covered by insurance, decrease or cutoff of income, indebtedness resulting from court judgments not due to the individual's financial mismanagement), provided the individual demonstrates efforts to respond to the indebtedness in a reasonable and responsible fashion.

5. Indebtedness due to failure of legitimate business efforts or business-related bankruptcy without evidence of fault or financial irresponsibility on the part of the individual, irresponsible mismanagement of an individual's funds by another who had fiduciary control or access to them without the individual's knowledge, or loss of assets as a victim of fraud or deceit, provided the individual demonstrates efforts to respond to the indebtedness in a reasonable and responsible fashion.

6. Any significant increase in net worth was due to legitimate business interests, inheritance or similar legal explanation.

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This study of financial irresponsibility as it relates to personnel security is prepared as background information for policy-makers, adjudicators, investigators, and researchers. It discusses the relationship between financial problems and personnel security, provides information on the prevalence of various types of financial problems in the U.S. population as a whole, describes ways to identify and judge the severity of financial problems, and points out the relationship between financial problems and other types of behavior of security interest.

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